C.D. Howe Institute

# Backgrounder

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## THE COST OF KEEPING PROMISES

### *Canada Can Ill Afford to Meet the Cost of the Parties' Campaign Pledges*

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As with every election call, numerous items awaiting Parliament's attention died on the order paper. However, one issue that never dies, but continues on from government to government, is the country's fiscal position. For the past 15 years, Canada has been accumulating an ever-increasing burden of national debt — a fact which should concern Canadians, since the growing need to service the debt cuts into government revenues and reduces fiscal flexibility.

That this burden should be so great in the fall of 1988 is particularly unfortunate. The current economic expansion is now passing its seventh anniversary, and the prospect of slower growth or even recession sometime in the next two years looks increasingly likely. Yet, because of the size of the debt, expected to reach some $321 billion at the end of the current fiscal year, and the importance of debt service charges, which account for roughly 30 cents of every dollar of federal government revenue, the government's ability to cushion the impact of an economic downturn with the sort of fiscal boost that Canadians have come to take for granted has become increasingly limited. This is the context in which the C.D. Howe Institute analyzes the election promises of the three major parties in this *Backgrounder*.

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## Big Ticket Areas: Each Party's Top 10

| *Liberals* | *NDP* | *Conservatives* |
|---|---|---|
| Environment | Environment | Environment |
| Child care | Child care | Child care |
| Senior citizens | Child benefits | Veterans |
| Youth employment | OAS increase | AIDS research |
| Employment/pay equity | GIS increase | Literacy |
| Literacy | Housing | Bilingualism |
| Housing | Culture | Film industry |
| Municipal infrastructure | Agriculture | Canadian T.V. content |
| Regional development | Single industry towns | Hibernia |
| Hibernia | Western diversification | OSLO |

### Promises, Promises

The growing severity of the debt problem contrasts strikingly with the trifling attention it receives during election campaigns. To a large degree, this neglect reflects the lack of a developed, concerned constituency, and the unattractiveness to politicians of limiting their platforms. In this election, the C.D. Howe Institute's long-standing concern with the state of federal finances has been heightened by the size of the spending promises that have been made in the run-up to the election, and by the inadequate attention that has been paid to their possible impact on the federal debt. The issue has also been clouded by the noncomparability of many of the costing figures that have been mentioned.

We have therefore been monitoring the pledges made by the Liberals, the New Democratic Party, and the Progressive Conservatives. Our analysis has involved estimating the fiscal impact on a year-by-year basis, and examining the implications for Canada's national indebtedness. Our estimates are based on the total party announcements made up to the time of publication; the big-ticket areas of spending for each party are highlighted in the box above. The results based on all spending announcements are summarized in the table on the next page.

The tally of new election-related commitments by the Liberals amounts to some $21.8 billion over the four years to the end of fiscal 1992/93. New interest payments stemming from the resulting higher deficits could add $4.7 billion to this figure, giving a total election-related additional increase in the national debt of $26.5 billion at the end of four years. This amount would be additional to the already considerable $99 billion increase projected in the February 1988 fiscal plan.

New spending promises by the NDP total some $16.7 billion over the four years. Of this amount, $13.5 billion, is offset by new taxes — based on NDP figures — giving a net figure of $3.2 billion over the period. New debt service costs of some $0.7 billion result in an increase in debt of about $3.8 billion by the end of 1992/93.

## *Estimated Impact of Election Promises, Fiscal Year 1989/90 to Fiscal Year 1992/93**

*($ billions)*

| | *Liberals* | | *NDP* | | *Conservatives* | |
|---|---|---|---|---|---|---|
| | Annual Average | Cumulative | Annual Average | Cumulative | Annual Average | Cumulative |
| Promised new expenditures | 5.5 | 21.8 | 4.2 | 16.7 | 0.8 | 3.2 |
| Plus additional interest cost | 1.2 | 4.7 | 0.2 | 0.7 | 0.2 | 0.6 |
| Minus new revenues | 0.0 | 0.0 | 3.4 | 13.5 | 0.0 | 0.0 |
| Equals increased borrowing | 6.6 | 26.5 | 1.0 | 3.8 | 0.9 | 3.8 |

Note: Figures may not add up exactly due to rounding.

* These figures are based on information available as of November 4, 1988. They are subject to change as new announcements and clarifications are made.

The Conservatives have pledged new spending amounting to $3.2 billion over the period. Additional interest costs of some $0.6 billion could leave the national debt $3.8 billion higher than it otherwise could have been after four years. The Conservatives maintain that their pledges are covered by reserves built into the spending estimates, but these reserves should not be regarded as money burning a hole in the finance minister's pocket. Canadians would be better off in future if the debt raised to cover this amount were to remain unborrowed.

The comparison of the parties' pledges naturally involves distinguishing new promises from the continuing business of government. We have included only new, specific spending commitments that were not included in the February 1988 budget. Care has been taken to keep comparisons between the parties on a common base. To the greatest extent possible, we have relied on figures provided by the parties themselves in our estimates of expenditures and revenues.

A few simple economic assumptions have been used: 3 percent real GDP growth, 4 percent inflation, and a 10 percent average interest rate on new debt. We have not incorporated higher tax revenues resulting from the fiscal stimulation of the new spending. (Nor, for that matter, have we incorporated the higher interest rates that buyers of government bonds would demand in the face of a widening deficit.) This sort of dynamic measurement would involve new estimates of the likely costs and revenues of the pledges, as well as their indirect impact on the economy, which goes beyond the object of this report.

### To Pay or Not to Pay?

As yet, these expenditures are only promises. The question arises as to how the party that forms the next government and inherits the fiscal position of the nation will act. There are three possible outcomes.

It is first of all possible that the results of these promises will fall short of expectations. The incoming government may announce that it has (re-)examined the books, has found the fiscal situation to be worse than expected, and will have to postpone some or all of its pledges. In this case, these billions simply represent the gap between rhetoric and reality inspired by an election campaign.

Or it may be that the spending promises are serious, and that it is only the way in which they are to be paid for that has been neglected. If so, there is another shoe still to drop. Canadians can expect increases in taxes above and beyond those that have figured in the campaign so far.

Finally, the promises can be taken at face value, in which case they suggest further additions to the national debt. But the cost of servicing this debt is now roughly equal to the deficit. We are running on a treadmill that will leave the net federal debt, according to the government's February calculations, at some $420 billion by the end of fiscal year 1992/93. This burden is already becoming hard to bear.

## How Much Debt Is Too Much?

The chronically low profile of this issue among the electorate is regrettable, because it is more and more difficult to remain complacent about the size of the problem. The federal government expects to record a deficit of $28.9 billion for the current fiscal year, ending in March 1989. This would bring net public debt up to $321 billion at the end of the fiscal year, a more than fivefold increase from ten years earlier. Over that decade, the size of the public debt relative to the economy will have risen more than twofold, from 25 percent of GDP to about 54 percent. (The addition of the debt of other levels of government would raise the latter figure to over 70 percent.) Not surprisingly, the interest paid on this debt has been the fastest growing category of federal spending.

A few comparisons give a sense of the degree to which other government priorities are being subordinated to debt service. During the latest fiscal year, the federal government paid out $29 billion in interest. This figure not only represented 30 percent of budgetary revenue, but it dwarfs many of the spending items that have been given a high profile in the election campaign. Last year's gross interest payments represented:

- more than twice the total of all federal spending on economic and regional development;
- more than twice the total of all elderly benefits — old age security, guaranteed income supplements, and spouses' allowances;
- almost three times the amount paid out in unemployment insurance benefits;
- more than four times the amount transferred to the provinces under established programs financing for health and education;
- some 15 times more than federal spending on job creation and training, and housing.

The burden of debt service has continued to grow over the past four years, despite the current government's success in bringing the deficit down by over $10 billion dollars — from $38.3 billion in 1984/85, the year the Conservatives came to power, to last year's $28.1 billion. Not only does the increasing pressure of interest payments threaten the next government's flexibility in dealing with an economic downturn, or in providing the new public services that an aging and increasingly environmentally conscious population will demand, it also makes the government's plans ever more vulnerable to changes in interest rates. A 1 percent increase in the average cost of servicing the debt at its current level would amount to about $3 billion annually. This extra expenditure would be equivalent to increasing this year's planned GIS payments by some 80 percent, or more than doubling the planned

government contribution to the Unemployment Insurance Account.

The unfortunate consequence of the emphasis on new spending pledges has been to obscure what should be the focus of the debate: how will the next government contain and reduce the deficit? The debt is already too high. Promises to increase it further will only make future attempts to cope with Canada's growing fiscal problem more difficult and painful. Unless Canadians are willing to address this fundamental issue soon, external creditors will force reality on us. Canada should remember the arrival of the IMF in Britain in the 1970s and the austerity currently being experienced in Ireland. Canada's debt problem is not something to be neglected or overlooked.

The C.D. Howe Institute is Canada's leading independent, nonpartisan, nonprofit, economic policy research institution. Its individual and corporate members are drawn from business, labor, agriculture, universities, and the professions.

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